W[h]ither Australia? Will Parliament Act?

Millhouse, David

Published in:
Law and Financial Markets Review

DOI:
10.1080/17521440.2020.1759218

W[h]ither Australia? Will Parliament Act?

Dr David G Millhouse

Faculty of Law, Bond University, Australia

Correspondence: dmillhouse@millhouse.co

Dr David Millhouse is an Honorary Adjunct Senior Research Fellow, Faculty of Law, Bond University. This paper represents the views of the author only and does not purport to represent Bond University or its Faculty of Law. He is the author of *Corporate Governance in Non-Bank Financial Entities* (LexisNexisButterworths, 2019).

This is an Accepted Manuscript of an article published by Taylor & Francis Group in Law and Financial Markets Review on 11/06/2020, available online: https://doi.org/10.1080/17521440.2020.1759218

W[h]ither Australia? Will Parliament Act?

Abstract

Australia is replete with commissions and inquiries into egregious behaviour in its financial sector. This author has quantified the effects of those behaviours on individuals and the wider economy.[1] These investigations include *Heydon*[2] (elimination of unhealthy culture), *Hayne*[3] (confluence of law and morality) and the *Productivity Commission*[4] (trust). The most important Hayne recommendations[5] — which would reduce Australia's international reputation as a regulatory outlier and better reflect community expectations remain unresolved. Confused parliamentary leadership has facilitated corruption of the financial regulatory system which has for many people been an abject disaster.[6] The Australian government must act. It must do so strategically. It must establish the nexus between the intent of the law and its practical implementation for those it purports to serve. Parliament has yet to debate the underlying causes focussing instead on tactical and punitive responses. If it does, then it must confront the distinction between prescriptive statute and principles-based supervision, recognising the power of antecedent fiduciary law. These are philosophical as well as legal questions. Hayne pointed to the need for a framework for the re-integration of the intent and spirit of the law with its statutory manifestations, presently scattered and inconsistent. This paper is that framework. Without it, much of the financial services and products sectors may continue its descent into the Stygian gloom of costly and inconsistent multi-layered bespoke regulation. An unintended consequence of paternalist policy will be fewer market participants, less choice and fewer opportunities to develop financial literacy.

1. Introduction

[1] David G Millhouse, 'Empirical Analysis supports the Hayne long run reform thesis' (2019) 13(2–3) *Law and Financial Markets Review* 81,162.
[2] Commonwealth, *Royal Commission into Trade Union Governance and Corruption* (Final Report, December 2015) ch 4, 10 (Commissioner Heydon) *('Heydon')*. See also Commonwealth, *Royal Commission into Trade Union Governance and Corruption* (Interim Report, December 2014) 904 (Commissioner Heydon);
[3] Commonwealth, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (2018) (Commissioner Hayne) (*'Hayne'*).
[4] Australian Government Productivity Commission, *Competition in the Australian Financial System* (Draft Report, January 2018); Australian Government Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness* (Report No 91, 2018) (*'Productivity Commission 2018'*).
[5] Hayne (n 3), recs 73 and 74, vol 1, 494-6.
[6] David G Millhouse, 'Systemic and Cyclical Failure in Australian Financial Services and Financial Products Sectors: Have weaknesses in law contributed to these failures?' (PhD Thesis, Bond University, 2019) ch 1 s 6.

This is an Accepted Manuscript of an article published by Taylor & Francis Group in Law and Financial Markets Review on 11/06/2020, available online: https://doi.org/10.1080/17521440.2020.1759218

Australia has a history of law reform designed to promote economic development circumvented and corrupted by malfeasors using legal complexities and omissions to further their own interests. The accretive culture, fragmentation and complexity of Australian law leads to uncertainty, ambiguity, and enforcement deadweight costs for investor and regulators. If Australia wishes to pursue an agenda of becoming a world financial centre, then law reform is an essential pre-condition.

Australia is a global outlier in many important aspects of its financial regulation. Specifically, it is almost unique in the use of trusts as large commercial trading enterprises, low licencing and capitalisation barriers to entry, limited fit and proper competency requirements, non-adherence to many International Organization of Securities Commissions (IOSCO) and Markets in Financial Instruments Directive (MiFID) 1 & 11 provisions, regulation of custody, and its poacher-gamekeeper model for Managed Investment Schemes (MIS).

Its corporate governance regime has often failed those it purports to protect — the investing public. Failure is not rare. Remediation is costly, with significant time elapsed to achieve limited financial outcomes. Subsequent regulatory response has been directly related to the degree of public pressure from those aggrieved seeking remedies as a result of a crisis, or a report driven by economic policy objectives. Many of the responses have been lacking insight and are mostly tactical.[7]

Judicial opinion has been scathing about the deficiencies and uncertainties in the law regulating Australian financial products and financial services.[8] Other legal opinion is equally severe: 'overly prescriptive, complex and poorly drafted [Product Disclosure Statements 'PDS']: The regime relies upon definitions within definitions and exceptions within exceptions. It is difficult for lawyers to get their heads around — let alone investors lacking in legal training'.[9]

Accretive statutory reforms alone, whilst superficially attractive given their relative ease of implementation, have not resolved systemic deficiencies in regulation. In Australia creative compliance occurs where statutory provisions are interpreted narrowly and abuse escaped close scrutiny.

---

[7] Chief Justice Paul de Jersey, 'Developments in Financial Services Law of the last 30 years' (Speech delivered at the Banking and Finance Services Law Association 30th Annual Conference, Gold Coast Qld, Australia, 30 August 2013).

[8] See, eg, *Rich v Australian Securities and Investments Commission* [2004] HCA 42 [122] (Kirby J); *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq)* [2012] FCA 1028 Summary 3 (Rares J); *Australian Securities and Investments Commission v Australian Property Custodian Holdings Limited (Receivers and Managers appointed) (in liquidation)(Controllers appointed)(No 3)* [2013] FCA 1342 (12 December 2013) [463] (Murphy J); *Re Environvest Ltd (No 4)* [2010] VSC 549 [2]–[3] (Judd J); *Aequitas v AEFC* [2001] NSWSC 14 [363] (Austin J); *Australian Softwood Forests Pty Ltd v Attorney-General (NSW) Ex Rel Corporate Affairs Commission* [1981] HCA 49 [37] (Murphy J); *Australian Securities and Investments Commission v Bridgecorp Finance Ltd* [2006] NSWSC 836 [17] (Barrett J) citing *Australian Securities and Investments Commission v Mauer-Swiss Securities Ltd* [2002] NSWSC 684 (Palmer J); *Trilogy Funds Management Limited v Sullivan (No 2)* [2015] FCA 1452 [1] (Wigney J); ASIC v Vines [2006] NSWSC 738 [14] (Austin J).

[9] Garry T Bigmore and Simon Rubenstein, 'Rights of Investors in Failed or Insolvent Managed Investment Schemes' in Stewart J Maiden (ed), *Insolvent Investments* (LexisNexis Butterworths, 2015) 238.

One court likened Australia's financial services and financial products industries to Dante's *Inferno*. It chose vivid adjectives 'byzantine' and 'purgatorial'.[10] This speaks loudly of the need for rational reform in the provision of financial products and financial services.

The reform goal must be clearly directed at restoring public trust, confidence, and respect. Fundamentally, this requires recognition of fiduciary obligations to investors and beneficiaries often wrongly assumed by them to exist. Holistic fiduciary standards in the investment chain is a different proposition from compliance with regulation. It leads to a different result.

Heydon[11] identified problematic deficiencies in regulation aided by an 'unhealthy culture'. He sought to excise unhealthy culture — 'if unchecked, the culture comes to taint and impact the wider society'.[12] 'History appears to be repeating itself …[13] It is a recurring problem…. it is insidious. It is immensely damaging … longstanding … clandestine …',[14] insightfully citing fiduciary duty as the antidote.

As Hayne noted:

> [G]iven the existing breadth and complexity of the regulation of the financial services industry, adding any new layer of law or regulation will add a new layer of compliance cost and complexity. […] [T]here is every chance that adding a new layer of law and regulation would only serve to distract attention from the very simple ideas that must inform the conduct of financial services entities.[15] [...] These ideas are very simple. Their simplicity points firmly towards a need to simplify the existing law [...] in the blizzard of [statutory] provisions, it is too easy to lose sight of those simple ideas that must inform the conduct of financial services entities.[16]

Hayne distinguishes between 'ticking boxes' and '[w]hat is the *right* thing to do?'[17] The '*right* thing' meets community expectations of fiduciary obligation in the investment chain. His most important recommendations,[18] being elimination of conflicts of interest and duty, establishment of behavioural norms through the conjunction of law and morality, and simplification of the law. This 'velvet hammer', being 'NewLaw, not more OldLaw'[19] will require significant parliamentary debate. His most important observation — 'the task of simplification grows harder and will take much longer … *because* the law is

[10] *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq)* [2012] FCA 1028 [118] (Rares J) ('*Wingecarribee*').
[11] Heydon (n 2).
[12] Ibid ch 4, 10.
[13] Ibid ch 4, 29–30 citing 1982 Winneke Royal Commission, 1992 Gyles Royal Commission, 2003 Cole Royal Commission.
[14] Ibid ch 4, [58].
[15] Hayne's 'simple ideas' are to: '[o]bey the law. Do not mislead or deceive. Be fair. Provide services that are fit for purpose. Deliver services with reasonable care and skill. When acting for another, act in the best interests of that other.'
[16] Hayne (n 3) vol 1 290.
[17] Ibid.
[18] Hayne (n 3) recs 7.3, 7.4 vol 1 494-496.
[19] Stuart Fuller, 'Hayne's velvet hammer nails the need for change' The Australian Financial Review, Sydney 15th February 2019.

now spread over so many different Acts and is as complex as it is … the very size of the task shows why it must be tackled.'[20]

This 'larger task' is supported by the ALRC,[21] noting that 'the common law and equity often achieved fundamental regulatory goals in a simpler way than statutes'.[22] This is entirely consistent with this authors' empirical analysis. If its predictive veracity is correct, [23] then the egregious behaviour uncovered by Heydon and Hayne and the Productivity Commission should give great cause for concern. The ALRC, noting that 'A good reform topic will have a broader policy context'[24] proposes a 36-month inquiry, yet to be funded by the Commonwealth. Despite agreeing to implement these important Hayne recommendations,[25] there is no legislative action.

Hayne 'marks the start and not the end of a process of change',[26] the basis for re-establishment of trust. Statutory reform, to eliminate present legal structure[s] within which financial services takes place,'[27] needs to follow. 'Without it, we privilege the illusion of reform, elevate the symbolic over the substantive, and contribute to a self-defeating deterioration in already low levels of public trust'.[28] That 'illusion of reform' continues in superannuation.[29] Political complicity, feeding upon naivety, and driven by interest groups[30] masquerading as professional associations have already blunted some of the Hayne recommendations.

The Productivity Commission recognises the practical limits of disclosure regulation, limited financial literacy competencies, recognising that behavioural economics provides important insights into policy formulation.[31] These practical limitations are exacerbated by conflicts of interest, particularly in vertically integrated businesses, proposing a 'legal duty of care'.[32] That proposed duty includes design

[20] Hayne (n 3) vol 1 495.
[21] Australian Law Reform Commission, *The Future of Law Reform: A Suggested Program of Work 2020-25* (Report, December 2019), 31-36 ('*ALRC 2019*').
[22] Ibid 34, citing Hon Chief Justice JLB Allsop AO, 'The Judicialisation of Values' (Speech, Law Council of Australia and Federal Court of Australia Joint Competition Law Conference, 30 August 2018 [11]– [15].
[23] Millhouse, (n 1) 176.
[24] ALRC 2019 (n 21), 15.
[25] Australian Government, *Restoring trust in Australia's financial system — The Government response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (February 2019) 38 (*'Restoring Trust 2019'*).
[26] Justin O'Brien, Private correspondence 1. See also, Justin O'Brien (2019) '"Because they could": Trust, Integrity, and Purpose in the Regulation of Corporate Governance in the Aftermath of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry; Justin O'Brien (2019) 'Trust, Accountability and Purpose — The Regulation of Corporate Governance, Corporate Governance (Cambridge Elements, ed Thomas Clarke UTS Business School, Sydney).
[27] Justin O'Brien, Private correspondence 2.
[28] Justin O'Brien, Private correspondence 3.
[29] See generally, Pamela F Hanrahan, Legal Framework Governing Aspects of the Australian Superannuation System Background Paper 25 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry ['Hayne'].
[30] Hayne (n 3) vol 1 495 citing Treasury, Interim Report Submission, 5 [23]–[25].
[31] Productivity Commission 2019 (n 4), ch 2, 85; pt 111, 352–356.
[32] Ibid ch 8, 227.

of a 21st century disclosure regime[33] where 'consumers resort to making decisions based on trust'.[34] For the Productivity Commission to achieve this policy objective, fiduciary obligation to quality assure the investment chain is an essential and inviolable precondition.

It is unfortunate that their analysis of best interest obligations of financial advisers under the FoFA regime is incomplete.[35] An uninformed reader might assume this is a statement of the law, which would be incorrect. Similarly, whilst a useful analysis of investor typology, there are no clear proposals for reform.[36] It is equally unfortunate to propose extending ASIC's mandate without an agreed plan to reform it. For ASIC to adopt a supervisory proactive posture will require its substantive reform. The Commission merely proposes further examination.[37] Community expectation that ASIC can police every commercial transaction is unaffordable, undesirable and unachievable. Itts mandate is being extended,[38] but it is 'not feasible to contract [ex ante] for every contingency'.[39]

There has been considerable discussion and government policy directed at Australia becoming at least a regional financial centre,[40] originally dating to Campbell in 1981 and Wallis in 1997. For that, Australia cannot remain an international outlier — its regulatory posture needs to reflect and build upon global norms.

[33] Ibid pt 111, 347, 366.
[34] Ibid pt 111, 355.
[35] Ibid app D3, 557.
[36] Ibid 560.
[37] Ibid ch 7, 473.
[38] Ibid pt 17.
[39] Sven Hoeppner and Christian Kirchner, 'Ex Ante versus Ex post Governance: A behavioural perspective' (2016) 12(2) *Review of Law and Economics* 227, 232.
[40] See, eg, Mark Johnson, *Australia as a Regional Financial Centre* (Financial Centre Forum Report, January 2010) ('*Johnson*'); Mark Johnson, *Australia as a Financial Centre Seven Years on* (Financial Services Council Report, June 2016).

2. More Statute, More Confusion

As Australian judicial frustration and scholarly opinion illustrates, present policy has led to the Age of Statutes:[41] a large increase in the volume and number of statutes, with often conflicting and confusing definitions of important basic terms. Reliance on statutory pre- and proscriptions has resulted in legislation that is labyrinthine:

> The definitions that mark out the regulatory perimeter are lengthy [and] often complex, and spread throughout the legislation. Within that perimeter, the rules themselves are highly specific and detailed: these are often made in response to relentless industry pressure on governments and regulators to supply black-letter prescriptive rules and guidelines that allow compliance risk to be managed internally by firms using a check-box approach … the legislation has been described as 'obscure and convoluted'.[42]

Wallis's market-based principles rely on disclosure and informed consent based on financial literacy. 'Labyrinthine' legislation has corrupted that intent. For example:

> Repeated attempts by government and regulators over the last 15 years to legislate for meaningful financial product disclosure have produced a patchwork of content requirements for PDS'S, spread across many hundreds of pages in the [*Corporations Act*], the Corporations Regulations and the Schedules to the Regulations, ASIC instruments and ASIC Regulatory Guides.[43]

In *Wingecarribee*:

> Those Acts that now deal with misleading and deceptive conduct, apply differently depending on distinctions such as whether the alleged misleading conduct is in relation to a 'financial product or a financial service',[44] or 'financial services'.[45] Those apparently simple terms are nothing of the sort. … Obviously, there are differences in what each of these Acts and definitions cover – but why? The cost to the community, business, the parties, and their lawyers, and the time for courts to work out which law applies have no rational or legal justification.[46]

Statutory accretion continues — recent examples include inter alia amendments to the *Corporations Act* implementing the FASEA Code of Ethics, The Design and Distribution Obligations, and Mortgage Broker best interest duty. All of these are paternalist in character. Despite Haynes' plea for simplicity, the differing best interest, responsible lending, DDO, and FASEA regimes make for exactly the opposite. Each of them operates independently and require their own record keeping.

---

[41] Mark Leeming, 'Equity: Ageless in the "Age of Statutes"' (2015) 9(2) *Journal of Equity* 108.
[42] Hanrahan, (n 29) 12 citing *Ku v Song* [2007] 1189 [175] (Graham J).
[43] Hanrahan, (n 29) 91.

[44] *Corporations Act 2001*(Cth) s 1041H(1).
[45] *Australian Securities and Investments Commission Act 2001* (Cth) s 12DA(1).
[46] See '*Wingecarribee*' (n 10).

Each of these new regimes are fiduciary-like, but do not apply either the noun or adjective 'fiduciary'. Relevantly, as Donald insightfully noted in the FoFA best interest context:

> It is ironic, then that those same political processes that are privileging these nobler qualities [of fiduciaries] are in fact de-coupling the regulatory regimes from the general law antecedents in which those qualities were initially expressed. Political processes are ensuring that what the law expects of Mason J's quintessential fiduciaries, or at least those whose activities encroach on areas of public policy, are regulated by multi-layered, highly specific, bespoke regulatory regimes that largely eclipse the proscriptions and prescriptions of the general law.[47]

Many market participants are small, sometimes family firms. It will be difficult and unaffordable for some to negotiate the Stygian gloom of fecund multi-layered regulation. The FASEA interpretation of retail financial consumer is not consistent with the DDO and other interpretations. Neither is it clear that financial consumers will benefit — paternalist policy does not encourage financial literacy. Unintended consequences of statutory accretion may well be fewer services, fewer investment products and greater costs.

The present danger is these tactical reforms be applied rigidly and onerously, becoming ends in themselves, rather than tools to benefit the financial consumer.[48] They are statutory reforms with significant and uncertain legal ramifications.

The FASEA best interest obligations[49]

FASEA was established by amendments to the *Corporations Act*.[50] It is new law and does not replace existing best interest provisions:[51] It is not an overlay on, or consistent with those provisions. FASEA is statutorily mandated to create and enforce a Code of Ethics.[52] Its best interest obligations compulsorily apply to 'relevant providers', being financial planners (now a restricted term) and their firms, and to 'monitoring bodies'. A monitoring body must have 'sufficient resources and expertise to appropriately monitor and enforce compliance with the Code of Ethics…'[53] This means that the relevant provider and the monitoring body must be able to decipher the Code's best interest duties.

Best interest duties appear in Standards 2 (broader, long-term interests, likely future circumstances, 3 (indirectly, through conflict of interest), 5 (client comprehension,

[47] M S Donald, 'Regulating for fiduciary qualities of conduct' (2013) *Journal of Equity* 142 [2].
[48] See, eg, Rt Hon Lord Denning, 'In the Court of Appeal — The need for a new equity', in *The Denning Family Story* (Centre for Commercial Law Bond University, 1981) 219, ch 10 227 [4][ii]. See also, Jesse Norman, *Adam Smith —What He thought, and Why it Matters* (Allen Lane Penguin Random House, 2018) Ch 10 The Moral Basis of Commercial Society.
[49] David G Millhouse, 'Best Interest Duties of Financial Advisers — More Law, more Confusion' (2020) *Enterprise Governance e-Journal*, Centre for Corporate Law, Bond University.
[50] *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017* (Cth).
[51] *Corporations Act 2001 (*Cth*)* Pt 7.7A Div 2 s 961B.
[52] Ibid s 921U(2)(b).
[53] Ibid s 921K.

appropriateness), 6 (broader, long-term interests), 7 (indirectly, through value for money), and 9 (broad effects, broader long-term interest, likely circumstances, competence). The Code 'must be read and applied as a whole'.[54] Therefore, other provisions which themselves have been problematic in financial services law, become relevant to the interpretation of best interest duties. These other duties include truly informed consent and client comprehension.

Doubtless, the Code and FASEA itself are well-intentioned responses to egregious behaviour identified by Hayne and others, quantified by this author.[55] It seeks to convert an industry into a profession. However, the FASEA Code of Ethics is unlike Codes of various forms in other jurisdictions which operate on a comply-or-explain basis.

In Australia a financial adviser may comply with the existing best interest provisions of the *Corporations Act*, with trustee obligations as if they were a fiduciary, maintain their 'punctilio of honour' and honesty, comply with their client contract, but nonetheless not be compliant with the FASEA Code of Ethics.

Despite the publication of cameos describing various client circumstances,[56] these are not cases, do not establish precedent, and are not law. There is no obligation for the publishers of these cameos to follow their own guidance in future litigation. In the meantime, financial advisers have unlimited personal liability – in quantum and in tenor, outcomes being dependent on future judicial determinations.

Future boards of FASEA will have no choice but to come to grips with the legal uncertainty its Code of Ethics has created. To quote David Pollard, 'Short Form Best Interest — Mad, Bad and Dangerous to know'.[57] The reading list for the compulsory examination[58] contains no direct authoritative references to the central questions of best interest and, because of the way the Code is drafted, other law (for instance, what constitutes 'informed consent') which support the best interest duties. This raises doubts about the veracity of the examination for the adviser in their quest for legal certainty.

Its objectives are doubtless pure, but its Code of Ethics does not have the jurisprudence and statutory support of pure liability civil law countries or the necessary supervisory architecture for effective implementation. These will take some years. In the meantime, the Code should operate

[54] FASEA, *Financial Planners and Advisers Code of Ethics* (Guidance FG002, 2019) 17 ('*FASEA 2019*').
[55] Millhouse, (n 1).
[56] FASEA 2019 (n 54) 6.
[57] David Pollard, 'The Short-form "Best Interests Duty" — Mad, Bad and Dangerous to Know: Part 1 — Background, Cowan v Scargill and MNRPF' 106, 136, 147 quoting Lord Nicholls, "Trustees and their broader community: Where duty, morality and ethics converge' (1995) 9 *Trust Law International* 7 cited in M Scott Donald, Submission to *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (21 September 2018) [3].

[58] FASEA, *Exam Preparation* (Guidance FG003, 2019) 6–9.

on a comply-or-explain basis. FASEA does not deploy 'fiduciary' either as noun or adjective, but that is the legal implication of its Code of Ethics. This new law is de-coupled from its general law antecedents.[59]

Financial Product Design and Distribution and Product Intervention Powers[60]

The DDO Act amends the *Corporations Act*, *National Consumer Credit Protection Act* and the *ASIC* Act. Originally proposed by *Murray*[61] in 2014, Its objective is to regulate the sale of financial products to retail consumers of those products. It seeks to do so by introducing statutory tests of appropriateness,[62] target market determinations[63], and financial product distribution conduct[64] by regulated persons[65]. ASIC may exempt persons or classes of persons.[66] Orders may be sought and made to redress loss of damage to financial consumers including declarations that contract be void or void *ab initio*.[67] There is some subjectivity — '[i]n considering whether a financial product has resulted in, or will or is likely to result in significant detriment to retail clients…'[68] Civil penalties apply.[69] Similar amendments are made to the *NCCP Act*.

Financial products include home mortgages, savings accounts, term deposits, prospectus and PDS offers of securities, hybrids, derivatives, all financial products regulated by the *ASIC Act* in respect of conscionability and consumer protection, and NCCPA products. In short, those products around which modern life exists.

A more useful approach might be reform of the three overlapping typologies of investor with ASIC using its exemption powers.

Mortgage broker best interest duty[70]

'Mortgage broker', as with financial adviser/planner is now a defined term. The best interest duty is in addition to responsible lending rules, and where relevant, DDO compliance and FASEA standards — these compliance obligations will depend on the business model of the broker. The new law eliminates the transactional implication of 'broker'. The provision of *any* 'credit

[59] See especially Donald, (n 47).
[60] *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers Act 2019* (Cth).
[61] David Murray, *Financial System Inquiry Final Report* (Australia Treasury, 2014) 198–205 ('*Murray*').
[62] *Corporations Act 2001* (Cth) Div 2 s 994B(8).
[63] Ibid s 994B.
[64] Ibid ss 994A, 994D,
[65] Ibid.
[66] Ibid s 994L.
[67] Ibid s 994Q.
[68] Ibid s 1023E(1).
[69] Ibid s 1023Q.
[70] *Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2019 Measures) Act 2020* (Cth). It amends the *National Consumer Credit Protection Act 2009* (Cth) ss 158LA and 158LE.

assistance'[71] which triggers the best interest obligation is not the same as personal financial advice but the boundaries and the compliance requirements inevitably will overlap. There is no 'safe harbour' prescriptive defence in the application of this best interest duty.[72] There is a statutory prohibition of contracting out of this duty.[73]

Emulating other financial services law[74] the best interest duty is different from management of conflicts of interest.[75] It follows the Australian statutory tradition of prioritisation rather than prohibition, further entrenching the vertical integration model. These related and close party transactions are a prime cause of egregious behaviour.[76]

The duty is subjective and may conflict with a client interpretation of their best interest[77] — fiduciary like, but not a fiduciary duty exercised by a status-based fiduciary. As with financial planners, it is possible to comply with other compliance obligations but not meet the best interest duty.[78]

3. Principles-based supervision

Hayne formulated six norms of conduct, 'but the reflection [in statute] is piecemeal'.[79] He recommended exceptions to norms of conduct be eliminated and should expressly state what fundamental norms … are being pursued … when detailed rules are made…[80] The Commonwealth agreed.[81] Parliament is yet to define 'norms' — 'when such norms are lacking, granting discretion to parties subject to principles-based regulation can become a blank che[que] for abuse'.[82] Norms define the limits of discretion. The FASEA Code of Ethics and the mortgage broker best interest duty rely on a principles-based approach to regulation and attempt to define contextual norms, but because of drafting, without the rules-based support of general law antecedents. It is this jurisprudence which give legal form to the vague terms scattered with abandon throughout Australian financial services and products law. 'Best interest' is but one.

---

[71] Australian Securities and Investments Commission, *Mortgage brokers: Best interests duty* (Regulatory Guide 0000, February 2020) RG 000 [105, 110] ('*ASIC 2020 Best interests'*).
[72] Ibid RG 0000 [11].
[73] Ibid RG 0000 [12]. See, eg, *ASIC v Citigroup*.
[74] See, eg, *Australian Prudential Regulation Authority v Kelaher* [2019] FCA 1521 (Jagot J) ('*Kelaher*').
[75] ASIC 2020 Best interests (n 71) [128]–[138].
[76] Millhouse, (n 1) 187.
[77] ASIC Best interests (n 71) [16, 45].

[78] Ibid [98].
[79] Hayne, (n 3) vol 1 9.
[80] Ibid 496 recs 7.3 and 7.4.
[81] Australian Government, *Restoring trust in Australia's financial system — The Government response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (February 2019) 38 ('*Restoring Trust'*).
[82] Steven L. Schwarcz, The 'Principles Paradox' (2009) 10 *European Business Organisation Law Review* 175,181.

Principles-based regulation is a spectrum of typologies with considerable scholarly debate.[83] It is not self-regulation.[84] Nor is it 'soft law', having multiple interpretations including lack of sanction and light touch based on disclosure. Other typologies include new governance, co-regulation, and responsive regulation.[85] The objective is to lower compliance costs for the financial consumer, improve regulatory outcomes, enhance jurisdictional competitiveness, provide for flexibility in ambiguous cases and facilitate better enforcement 'for infractions … [which] despite achieving technical compliance, violate the public interest.[86]

Principles-based regulation, once norms are defined, requires interpretation by the stakeholding group — requiring 'considerable changes to the traditional regulatory culture'.[87] This includes multi-disciplinary interpretive skills which have been lacking in the oversight of many Australian MIS. Principles-based regulation 'derives its legitimacy from its collaborative, dialogic experience … it operates on … pragmatic, learning by doing experience…[88] It is iterative. The regulator becomes a supervisory and educative ex ante stakeholder, defining norms and themes. This extends to not prescribing 'specific examinations'.[89] This posture reflects the complexity of financial systems and products which underpin a modern entrepreneurial economy.

Australia is a long way from that outcome, its tentative evolution into principles-based law flawed. It relies on 'creating ever-longer lists of prohibited behaviour or checklists of compliance-related best practices … [which] will not be effective if the basic culture of the firm does not foster law-abiding behaviour'.[90] Australian law has legitimised the wrong behaviours.

Principles-based regulation requires meaningful enforcement. Stakeholder acceptance results in consensus and regulatory penalty for acting outside of the norms. Conversely, acting within norms can legitimise reputation and add brand and economic value. Brand value in effect becomes social licence. In Australia, as Hayne demonstrated, that licence was shredded. Similarly, Germany when it adopted (but later revoked) non-traditional legal norms.

[83] See, eg, Lawrence A. Cunningham, 'A Prescription to Retire the Rhetoric of "Principles-Based Systems" in Corporate Law, Securities Regulation and Accounting' (2007) Boston College Law School Research Paper No. 127 cited in Christie L. Ford, 'New Governance, Compliance, and Principles-Based Securities Regulation (2008) 45 *American Business Law Journal* 1, 10.
[84] Christie L. Ford, 'Principles-Based Securities Regulation in the Wake of the Global Financial Crisis' (2010) 55 *McGill Law Journal* 257, 283.
[85] Ibid 285.
[86] Barbara Hendrickson, Larry Markowitz, Shahen Mirakian, and Marty Vendalaien, '2009 Report of the Expert Panel on Securities Regulation in Canada' *CBA National Business Law Newsletter* 4.
[87] Christie L. Ford, 'Principles-Based Securities Regulation in the Wake of the Global Financial Crisis' (2010) 55 *McGill Law Journal* 257, 288.
[88] Ibid 305.
[89] Christie L. Ford, 'New Governance, Compliance, and Principles-Based Securities Regulation (2008) 45 *American Business Law Journal* 1, 15.

[90] Ibid 29.

4. Lessons from other jurisdictions

The German (EU), Canada, US, UK, and Singapore jurisdictions demonstrate there is no one solution to the resolution of systemic problems in those jurisdictions and manifested in Australia. These experiences fall into two distinct categories — strategic policy reforms and tactical statutory reforms.

A study of comparative jurisdictions is insightful: '[C]ross-country differences in legal systems and accounting standards help to explain the cross-country differences in the development of financial intermediaries'.[91] '[C]ountries with a German legal origin have better-developed financial intermediaries…'[92] with particular insights into regulatory posture, fiduciary-equivalent obligation, and the relationship between regulation and corporate governance. Of the common law jurisdictions, Canada has the closest affinity with the traditional German civil law model. Germany has the closest pure liability model of relevant jurisdictions. When Germany in 2007 departed temporarily from its legal traditions in NBFE regulation, consequences were similar to those in Australia: 'Heuschrecken'[93] descended, necessitating reversion to legal traditions, now codified in EU statutes.

These insights are of practical relevance. If emulated, they could significantly improve Australian law and regulation. They provide the basis for the re-establishment of investor trust and confidence and enhancement of national economic productivity. Inter-jurisdictional transfer difficulties can arise, but the more successful regulatory experiences in comparative jurisdictions provide reform options to address identified systemic deficiencies in Australia.

The *untreue*[94] principle, now codified in EU law and supported by the German Corporate Governance Code (GCGC) as general law governs intent. German directors are required to observe the spirit and intent of the law, not only its statutory manifestations, balanced by codified civil law counterweights. This architecture reflects fiduciary stewardship concepts. This is not so in Australia unless there is a broadened fiduciary relationship where, as in the UK, '[i]t [creative compliance] is essentially the practice of using the letter of the law to defeat its spirit, and to do so with impunity'.[95]

For Australian investors, adoption of these doctrines would extend duties of advisers beyond present statutory best interest with a personal conduct obligation to explain, fully disclose, deal fairly and positively pursue their economic interests, now expressed in the FASEA Code of Ethics but without recourse to general law antecedents. German legal tradition has facilitated the maturity of its private banking sector,

[91] J Carmichael and M Pomerleano, *The development and regulation of Non-Bank Financial Institutions* (Report, World Bank, 2002) 13, citing Ross Levine, Norman Loaya and Thorsten Beck, 'Financial Intermediation and Growth: Causality and Causes' (World Bank Development Research Group, 1999).
[92] Ibid 199.
[93] Locusts [author's trans].
[94] Luca Enriques, 'Related Party Transactions: Policy Options and Real-World Challenges (with a Critique of the European Commission Proposal)' (2015) 16 *European Business Organisation Law Review* 24.
[95] Simon Ashby, 'The Turner Review on the Global Banking Crisis: A Response from the Financial Services Forum' (Nottingham University, 2009) 17.

yet to be emulated in Australia. In Germany, investors are now consumers of financial products and services, not capital suppliers. This is a completely different posture to previous Australian market practices.

Canada has significantly extended fiduciary doctrine across the investment chain, adopted Responsive Regulation, financial advisers having a direct, prescriptive fiduciary nexus with whom they deal. By contrast, regulation in the US is a politicised, convoluted, unresolved, inconsistent mess blowing with the political winds of the day. Its fragmented regulatory architecture, which has led to jurisdiction shopping, 'has been heavily discredited'.[96]

Singapore has a national strategy of being a global financial hub, using other regulatory methods. These include statutory personal liability in financial advice, personal fiduciary liability for directors of actively managed collective investment schemes (CIS) regulated by its *Business Trusts Act*[97] (the equivalent of Australian unregistered MIS), and much greater barriers to entry for market participants.

In Germany, BaFin[98] does have wide ranging principles-based powers,[99] based on concepts of 'natural politeness'.[100] This regulatory model is culturally specific. It follows enlightened post-war legal concepts designed to promote a civil society, redolent of MAS' objectives in Singapore. Hanrahan and Kingsford Smith[101] insightfully favour a similar approach over Australias' box-ticking regulatory culture. Germany 'has realised that a lot can be gained by employing principle-based regulation'.[102]

Similarity with Singapore extends to practical assessment of what is possible: 'Financial supervisors cannot be expected to reduce the probability of financial intermediaries' excessive risk taking to zero, nor can they start enforcement actions every time they are alerted about a possible compliance issue'.[103]

The UK has attempted to quality assure its investment chain by proposing substantially extended fiduciary obligation, eliminating legal ability to contract out of that obligation, and extending it to end beneficiary. To date, those attempts have failed. The need for reform was accepted by the UK authorities, but did not extend to the adoption of statutory fiduciary duties of those in the investment chain.[104] Rather, best interest

[96] Symposium, 'Global Financial Crisis: The Way Forward' (9 April 2010) Bond University; Carmichael, 'Regulatory Lessons from the Crisis', above n 11.
[97] *Business Trusts Act* (Singapore, Act 30 of 2004).
[98] Bundesaufsichtsamt für Finanzdienstleistungen [Federal Financial Services Authority].
[99] *Securities Trading Act* 1998 (Germany) ('WpHG') §§ 15(2)(2), 20a(5)(5).
[100] R Veil, 'Enforcement of Capital Markets Law in Europe — Observations from a civil law country' (2010) 11 *European Business Organisation Law Review* 409, 414.
[101] Dimity Kingsford Smith, 'ASIC regulation for the investor as consumer' (2011) 29 (5) *Companies and Securities Law Journal* 336; Dimity Kingsford Smith, 'A harder nut to crack? Responsive Regulation in the financial services sector' (2011) 44 (3) *University of British Columbia Law Review* 702; Pamela Hanrahan, 'ASIC and managed investments' (2011) 29 *Companies and Securities Law Journal* 297.
[102] Veil, (n 100) 417.
[103] Luca Enriques and Gerard Hertig, 'Improving the governance of Financial Supervisors' (2011) 12 *European Business Organisation Law Review* 357, 375.
[104] Law Commission UK, *Fiduciary Duties of Investment Advisers* (Consultation Paper No 215, 22 October 2013) 4. ('*Fiduciary Duties UK 2013'*).

is interpreted as best long term interest consistent with the *Companies Act.*[105] It 'enshrines …"enlightened shareholder value"'[106] and 'generally prevailing standards of decent behaviour'.[107] These standards incorporate concepts of stewardship[108] into governance requiring reporting or publicly disclosing compliance.[109] Whilst administrative, voluntary (except for listed companies) and resting in the duty of care, it implies the application of fiduciary principles to participants in the investment chain rather than an explicit statutory fiduciary duty. It also implies an extension of those fiduciary principles from proscription to positive duties. 'Some stakeholders argue[d] that stewardship should be "an explicit part of fiduciary duty"'.[110] The present position is a voluntary adoption of the *Stewardship Code* with explanations required for non-adoption,[111] (as in Germany).

The Canadian regulatory system has much to offer Australia in its quest for reform of regulation. Canada 'has led the way in the common law world in extending fiduciary obligations and remedies',[112] to eliminate vague assertion[s] of fiduciary expectations by the community not met in practice. That phenomenon is not restricted to Australia: '[f]iduciary law everywhere has eluded a sound theory of liability'.[113] 'While inequality, dependence, and vulnerability are now routinely identified as qualities of fiduciary relationships that justify fiduciary duties, their meaning and salience have not been consistently stated or properly explained'.[114]

In Canada and elsewhere there were implicit community fiduciary assumptions.[115] These have subsequently been given definition in Canada, requiring the existence of discretionary power of the fiduciary which can affect the legal position of the beneficiary.[116]

US States have different interpretations of fiduciary duty. As a general proposition, broader than those in Australia: Delaware classifies duty of care and good faith as fiduciary alongside loyalty. Some require a surety bond to underwrite the obligations of the fiduciary. Imposition of strict fiduciary standards in some states does not adversely impact financial service providers. Empirical research finds

[105] *Companies Act 2006* (UK) s 172.
[106] Fiduciary Duties UK (n 104) 63.
[107] Ibid 5.
[108] *The UK Stewardship Code* (Financial Reporting Council, 2012) Principle 1.
[109] *Conduct of Business Source Book* (Financial Conduct Authority UK) 2.2.3R.
[110] Fiduciary Duties UK 2013 (n 104) 144 citing Lord Myners (Third Report of the Select Committee on Business, Innovation and Skills UK, 2013–14) House of Commons 603 Evidence 19.
[111] Law Commission UK, *Fiduciary Duties of Investment Intermediaries* (Consultation Paper No 350, 30 June 2014) [5.83].
[112] Paul B Miller, 'A Theory of Fiduciary Liability' (2011) 56(2*) McGill Law Journal* 235 [4].
[113] Ibid [5].
[114] Ibid [48].
[115] *Guerin v Canada* [1984] 13 DLR (4th) 321; See also *Hospital Products Ltd v US Surgical Corp* [1984] 156 CLR [72] (Mason, Gibbs, Dawson JJ).
[116] *Galambos v Perez* [1998] 166 DLR (4th) 475.

> no statistical difference between the two groups[117] in the percentage of lower-income and high-wealth clients, the ability to provide a broad range of [financial] products including those that provide commission compensation, the ability to provide tailored advice, and the cost of compliance.[118]

This is important research for Australia where lobby groups decry high regulatory standards as anti-entrepreneurial. Fiduciary law impacts more than those directly party to the fiduciary relationship. Meeting community expectations is a matter of public interest and can be an outcome of fiduciary law and breaches of it in those relationships.[119]

Reliance on common law and lack of a statutory uniform standard has not prevented and may have induced a code of self-regulation consistent with ISO 9000 Quality Management System standards. This culminates in a 'periodic table of global fiduciary practices'.[120] This Global Fiduciary Standard, in stark contrast to some Australian statutes, recognises that 'procedural prudence alone does not complete a fiduciary's obligations'.[121] It notes that:

> the vast majority of the world's liquid wealth is in the hands of investment fiduciaries and the success or failure of investment fiduciaries can have a material impact on the fiscal health of any country[122] … earning trust is not simply a matter of recent, superior performance, dazzling presentations, or personal relationships: it is a matter of organisational integrity and process driven by prudent practices.[123]

The Global Fiduciary Standard is an attempt to quality assure the investment chain. It encompasses all those statutorily recognised in US Federal and State law.[124] It provides a managerial basis for international harmonisation and application of fiduciary principles in governance. The Global Fiduciary Standard is highly prescriptive requiring positive actions.[125] Similarly, the UN Fiduciary Duty in the 21st Century Program concludes: 'failing to consider all long-term investment *value* drivers, including ESG issues, is a failure of fiduciary duty'.[126] Necessarily, this implies positive actions.

---

[117] These two groups were a sample of financial advisers drawn from states with no fiduciary standard and from those with strict fiduciary standards.
[118] Michael S Finker and Thomas Patrick Langdon, 'The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice' (Elsevier, 2012) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2019090>.
[119] Cheryl L Wade, 'Fiduciary Duty and the Public Interest' (2011) 91 *Boston University Law Review* 1191 quoting Tamar T Frankel, *Fiduciary Law* (Oxford University Press, 2011) 52. For a fuller discussion, see Symposium, 'The Role of Fiduciary Law and Trust in the Twenty-First Century: A Conference Inspired by the Work of Tamar Frankel' (Boston University School of Law, 29 October 2010).
[120] Centre for Fiduciary Excellence LLC and fi360 inc 112013, *Prudent Practices for Investment Managers*: *Defining a Global Fiduciary Standard of Excellence*, Worldwide edition, 2013. This edition is supported by extensive handbooks and working documents.
[121] Ibid 8.
[122] Ibid 6.
[123] Ibid 7.
[124] For instance, but not exclusively those providing advice or asset management under the *Investment Advisers Act 1940* (US), *Pension Protection Act 2006* (US), and State securities laws.

[125] David G Millhouse, *Corporate Governance in Non-Bank Financial Entities* (LexisNexisButterworths, 2019) ch 6 [6.120].
[126] United Nations Environment Program 'Fiduciary Duty in the 21st Century' (2015) <http://www.unpri.org/download_report/6131>. This author's italics.

Harmonisation with international standards — UCITS and the Australian Funds Passport Regime

To reduce Australia's outlier status, Australian law applying to financial products and financial services could be harmonised with similar jurisdictions. This includes not only adherence to Global Fiduciary Standards principles but also to IOSCO and MiFID regimes. These already operate internationally. Australian financial product disclosure documents could adhere to UCITS principles to enable the sale of Australian financial products in other jurisdictions. Conversely, Australia could permit the domestic sale of international UCITS compliant financial products to stimulate financial product competition. There has been some progress with 'passporting' but this remains far from complete,[127] and high barriers to entry make it very restrictive.

5. Does law underpin a modern economy?

Some authors[128] claim causality between legal origins and financial market outcomes, a primary legal distinction being common and civil law origins.

> Legal protections not only facilitate diversification of financial commitments by the existing investor base, but also and in addition, must encourage small investors to put their savings in equity. This then leads to the broadening of the investor base which is associated with bigger and deeper markets. Thus law begets markets.[129]

Comparative law research supports this conclusion, with differing legal methods achieving similar desired outcomes for investors. Similarly, differing jurisdictions influence market practices using methods other than legal tools to implement policy reform: 'law is hardly ever the only or even the culprit of a crisis. Conversely, legal solutions are not necessarily the most important remedy … actual change is contingent on non-legal factors...'[130] The importance of behavioural economics research is understated and under-researched in Australia, where emphasis on statutory accretion serves as 'diagnostic tools for policy reform'.[131] Emphasis on objective strategy based on multiple tools would serve to reduce the impact of interest group driven politicised policy.

[127] Originally proposed by Johnson in 2009, legislation for Asian Region Funds Passport (ARFP) and Corporate Collective Investment Vehicles (CCIV) incorporates new chapters 8A and 8B in the *Corporations Act 2001* (Cth). *Corporations Amendment (Asian Region Funds Passport) Act 2018* (Cth) received Royal Assent on 29th June 2019. Treasury Laws Amendment (Corporate Collective Investment Vehicle) Bill 2018 remains in the legislature. These allow for multi-jurisdictional financial product distribution (New Zealand, Hong Kong, South Korea, Thailand, Singapore, Philippines, Japan and Australia have participated in consultations). The Passport is based on mutual recognition principles. Related party transactions are regulated in the home country. UCITS principles are accorded worlds' best practice for custody. The legislation provides for the SLE model in both corporate and limited partnership forms with directors duties giving priority to investors over shareholders.

[128] Katharina Pistor, 'Rethinking the "Law and Finance" Paradigm' (2009) *Brigham Young University Law Review* 1113.

[129] Ibid 1650.

[130] Ibid 1669.

[131] Ibid 1658.

The Law Matters thesis[132] postulates that jurisprudence underpins a competitive economy. The law can facilitate economic development and not simply coerce, regulate and control.[133] Evidence can be found in Europe. EU law reform of retail investor capital markets was estimated to increase EU GDP by 'between 0.5 and 0.7% [pa].'[134]

The Law Matters: its manifest deficiencies have been one reason for the paucity of global firms originating or based in Australia. This has led to fewer on-shore investment opportunities for superannuation funds, capital flight to other jurisdictions, entrepreneur flight, suboptimal GDP growth, reducing skilled employment opportunities for the population. Australia,

> needs a system that evades the risk aversion that has become common practice and returns to our roots as an entrepreneurial community … In the 21st century regulation needs to avoid paternalism without completely abandoning prudent protection of interest.[135]

Whilst law matters, it is problematic to assume that government regulation alone can drive market behaviour. In practice intertwined European and national jurisdiction mix of soft law through self-regulation, co-regulation, and government regulation, disciplined by the primacy of civil law principles and the statutory powers of minority shareholders produces results: 'Firms begin to avail themselves of corporate governance principles codes, guidelines and laws, thereby leaving the "box-ticking" phase behind'.[136] This is a salutary lesson for present Australian practice.

6. Framework for implementation

Australian public policy is at a cross-roads. There is a considerable risk that the egregious behaviour quantified by this author and other entities examined by Hayne will result in more statutory intervention, more regulatory intervention ('Why not litigate?') a less entrepreneurial economy, higher costs, reduced availability of capital, and fewer market participants. Perhaps not a return to oligopoly, but nonetheless more restrictive and less internationally competitive. The Productivity Commission proposes to extend ASIC's mandate to competition.[137] Whilst acknowledging the need for substantive ASIC reform,[138] it proposes to repeat the error

[132] Brian R Cheffins, 'Corporate Law and ownership structure: A Darwinian Link?' (2002) 25(2) *University of New South Wales Law Journal* 346 [2] citing Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property* (Macmillan, 1932).
[133] Justice Michael Kirby, 'The company director: past, present, and future' (Speech delivered at the Australian Institute of Company Directors, Tasmanian Division, Hobart, 1998).
[134] Friedrich Heinemann and Mathias Jopp, *The benefits of a Working European Retail Market for Financial Services* (Report to the European Financial Services Round Table, Institute für Europäische Politik, Berlin, 2002); See generally Moloney, Building a Retail Investment Culture through Law: The Markets in Financial Instruments Directive (2005) 6 *European Business Organisation Law Review* 341, 354 citing Heinemann and Jopp (n 134). See also below (n 258).
[135] Australian Association of Angel Investors, Equity Crowdfunding; Response to the Treasury Consultation Paper (2015).
[136] Joseph A McCahery and Erik P M Vermuelen, 'Private Equity and Hedge Fund Activism: Explaining the Differences in Regulatory Responses' (2008) 9 *European Business Organisation Law Review* 535, 537.
[137] Productivity Commission 2018 (n 4).
[138] Ibid 24.

identified by Ashby in 2009 following UK regulator reform in 2007: 'our regulators have been part of the problem'.[139]

2020 is the end of the beginning of modern Australian financial reform which began in 1981. Choice of road is at hand. Parliament must decide. Haynes' important systemic recommendations[140] are consistent with this paper. It proposes the 'Age of Statutes' evolve to the 'Age of Trust', firmly rooted in the fertile soil of Scott Donalds' 'nobler qualities'[141] of fiduciaries. Those fiduciary qualities are implicit in community expectation of trust and loyalty on whom they rely, forming the basis of a modern regulatory regime.

What does Australia wish to achieve as a modern nation? Does it wish to develop its modern story as an entrepreneurial economy competing with its global peers? Does it remain largely reliant on resources extraction and low value employment? Does it want to leverage off innovation and skills? Does it want to develop its SME sector? The answers to these questions determine future public policy in financial services and products regulation. Does Australia continue its tradition of statutory accretion which has allowed egregious behaviour to flourish? Or do the insights in this paper provide a framework? This the cross-road that Parliament must now traverse. It is a binary choice.

If the former road, then this paper predicts that the future will be similar to the recent past. If not, then Australia must undertake reform of financial regulation as proposed in this paper. Entrepreneurial freedoms must be matched by participant acceptance of fiduciary obligation to guide and enforce market conduct standards — the two are symbiotic. This is evolutionary, some may say revolutionary. It is not revolutionary: it returns, as Hayne proposed, Australian financial regulation to a positive culture of trust, honesty and fair dealing.[142] That is a culture that provides for entrepreneurship, business growth and future employment.

However, it is not merely a matter of law, something missed by those who prescribe statutory remedy for every ill. That is the easier route — the quick fix, the instant medication. This paper identifies the more thoughtful route, assuredly taking time to effect cultural change, but of a permanence based on common easily comprehended principles.

Parliament has yet to debate these issues. If it does, then it must confront the distinction between fiduciary and non-fiduciary duties and recognise the power of fiduciary law. Confused parliamentary leadership has facilitated corruption of the regulatory system.'[I]t is important [to] preserve fiduciary law … at least until

[139] Ashby, (n 95), 33.
[140] Hayne (n 3), recs 73 and 74, vol 1, 494-6.
[141] Donald, (n 47) 142 [1].
[142] See, eg, *Bray v Ford* [1895–99] All ER 1009, 1011. Lord Herschell noted that: 'human nature being what it is, there is a danger … of the person holding a fiduciary position being swayed by interest rather than duty, and thus prejudicing those whom he was bound to protect. It has, therefore, been deemed expedient to la[y] down this positive [inflexible] rule.'

a basis for expanding fiduciary law so that it incorporates prescriptive obligations is articulated rationally and accepted'.[143]

Four strategic themes in Law Reform

This paper proposes strategic re-order of Australia's regulatory architecture supported by effective, untainted and efficient corporate governance for effective implementation — statutory amendment alone will not suffice.

As Hayne also identified, reform is a system-wide view; it is doctrinal, requiring absolute obedience to the spirit of the law to reflect community expectation of fiduciary trust and loyalty. It removes incentives for malfeasance and improves incentives for lifting standards rather than reliance on proscriptive and prescriptive box-ticking compliance alone. Reform is designed to enhance financial sector performance for financial consumers and applies to all elements in the investment chain, including its regulators.

The four strategic reform themes are:

- Re-establishment of trust in the investment chain through fiduciary obligation;
- Architecture for implementation at the financial consumer level — financial planning and wealth management as a profession;
- Market conduct regulation for the 21st century; and
- Corporate governance reform — related party transactions and conflicts of interest.

Implementation of the four reform themes will require national leadership — from Parliament given form by the Executive. It will require four implementation teams for four years: stakeholder support is essential. Some of these will overlap. A senior Parliamentary ministerial champion supported by a special purpose Reference Group with Commonwealth financial support noting a similar proposal from the ALRC. It could be based on the inoperative but extant Financial Sector Advisory Council. Implementation should be considered as a decade long policy objective working in tandem with the Council of Financial Regulators (CFR). The CFR should have an enhanced mandate to supervise implementation within its regulator stakeholder group. Within each theme, specific tactical legislative interventions are needed. The Corporate Law Economic Reform Program (CLERP) provides a precedent. These four themes will require considerable statutory support, for consistency guided by the Reference Group and the responsible minister. The CFR will consider and publicly explain in a comprehensive transparent way what the impact of the reform themes are. It is:

> a vehicle for improving regulators' ability to influence expectation in financial markets. It can build trust in the actions of regulators. But of greatest value is its capacity to be a forum that can test the proposition of a macroprudential intervention…[144]

[143] Matthew Harding, 'Two fiduciary fallacies' (2007) 2 *Journal of Equity* 1, 25.
[144] Productivity Commission 2018 (n 4).

This is consistent with the need for a competition advocate, and consistent with this thematic reform program, not separate from it. 'For ASIC to act as a champion of financial system competition would require a clear change … and a change in its regulatory culture',[145] extending 'towards advancing *consumer's* interest in financial products … That it has not already done so is of concern'.[146]

Some stakeholders will be challenged: others, the qualitative research identifies,[147] will be supportive. All stakeholders must focus on the uncompromised needs of investors and beneficiaries in the investment chain, not their own sectoral interests. There must be commonality of objective disciplined by a financially empowered literate community led by champions.

7. Re-establishment of trust in the investment chain through fiduciary obligation

Australian courts have previously resisted extension of fiduciary obligations 'to be used for creating new forms of civil wrong [being an] 'unsatisfactory development of the law of fiduciary obligation'.[148] 'It is questionable in my view whether this heralded development in our law is a desirable or necessary one [in the trust company context]'[149] However, elimination of systemic deficiencies in Australia's financial advice sector will require such extensions of fiduciary obligation. Judicial opinion where fiduciary obligation has been limited to strict proscriptions is contextually narrow and should not limit non-contextual cases to those narrow confines. There are precedents in Australian case law based on contract,[150] vulnerability and reliance,[151] reasonable expectation,[152] and in the extension of trustee director statutory fiduciary liability to Australian superannuation entity members personally.[153]

Fiduciary obligation is the mirror of community expectation of trust in those that advise them or manage their funds. 'Fiduciary law cannot be subsumed under contract … a violation of fiduciary duties carries a "moral taint". … Unlike contract, trust is a moral relationship; its unwarranted violation is a moral principle'.[154] In Australia, there is a trust deficit.

> Since an underlying motivation of the imposition of fiduciary obligations is to maintain public confidence in socially important relationships like that of investment, the routine circumvention of such obligations raises public policy concerns.[155]

[145] Ibid.
[146] Ibid.
[147] Millhouse, (n 6) app 1.
[148] *Westpac Banking Corporation v The Bell Group Ltd (in liq) [No 3]* [2012] WASCA 157 [901] (Lee J, Drummond AJA).
[149] *Australian Securities Commission v AS Nominees Limited, Ample Funds Limited, AS Securities Limited and Peter Grenfell Windsor* [1995] FCA 1663 [78] (Finn J).
[150] *Hospital Products Ltd v US Surgical Corp* [1984] 156 CLR [72] (Gibbs J).
[151] Ibid [142] (Dawson J).
[152] *Mabo v State of Queensland (no 2)* [1992] 175 CLR 1 [200]–[201] (Toohey J).
[153] *Superannuation Industry (Supervision) Act 1993* (Cth) ss 52A(d), 55A(4A), 52(8), 29VN (a), (b).
[154] Richard Holton, 'Fiduciary Relations and the Nature of Trust' (2011) 91 *Boston University Law Review* 991, 994 quoting Tamar T Frankel, *Fiduciary Law* (Oxford University Press, 2011) 238.
[155] Andrew Tuch, 'Investment Banks as Fiduciaries: Implications for Conflicts of Interest' (2005) 29 *Melbourne University Law Review* 478, 516.

Fiduciary relationships can and should be found at every point in the investment chain where there is discretion, information, reliance or advice. The imposition of statutory fiduciary duty directly in the investment chain has not been previously viewed with undiluted pleasure.[156] However, 'superannuation entity director' is now enshrined in the *SIS Act* with direct fiduciary obligations to the beneficiary,[157] and in the *Corporations Act*[158] for MIS securities holders. The need to apply fiduciary law to investment banks (in their various formulations as financial conglomerates) has long been recognised in Australia.[159] The need is to re-establish foregone trust, confidence and respect in fiduciaries required to act as if they should be trusted. This outcome is unlikely to be achieved with prescriptive administrative regulation. It is 'not just a policy choice, but an architectural choice about how our law fits together'.[160]

The preferred view (which is the position in comparative jurisdictions) is that the contextual judicial determinations 'do not apply to the [non-contextual] status-based fiduciary relationships such as that between director and company'.[161] This is a fundamental point of law striking directly at the mismatch between community expectations and market practice of those in the investment chain. 'It is a duty of fundamental importance',[162] being an essential part of undivided loyalty.

Scholarly research concludes:

> The existing state of Australian law in its approach to fiduciary duties lacks clarity and cohesion, particularly as concerns directors. Implementation of the proposals in this thesis would bring certainty and consistency … it paves the way for the rethinking of modern fiduciary theory'.[163]

This, and Langford's other proposals for 'extensive international analysis … [and for] corporate governance … organised and categorised around fiduciary duties'[164] are entirely consistent with the analysis of this author.[165] The essential power of fiduciary law is its very fluidity.[166]

---

[156] *Australian Securities and Investments Commission v AS Nominees Limited, Ample Funds Limited, AS Securities Pty Ltd and Peter Grenfell Windsor* [1995] FCA 1663 [77]–[78] (Finn J).
[157] *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act* 2012 (Cth) Explanatory Memorandum [1.33].
[158] *Corporations Act 2001* (Cth) ss 601FD, 601FC.
[159] See, eg, Tuch, (n 155).
[160] Joshua Getzler, '"As If" – Accountability and Counterfactual Trust' (2011) 91 *Boston University Law Review* 973, 988.
[161] R T Langford, 'The duty of directors to act bona fide in the interests of the company: a positive fiduciary duty?', 231.
[162] R P Austin, H A J Ford and I M Ramsay (eds), *Company Directors – Principles of Law and Corporate Governance* (LexisNexis Butterworths, 2005) [11.1] cited in Langford, 'The duty of directors to act bona fide in the interests of the company', (n 161) 232; see especially Langford, *The Bona Fide Fiduciary Loyalty of Australian Company Directors*, PhD thesis, Faculty of Law Monash University, 2013, 313–314 [10.12], [5.3.1.1] citing *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64; 156 CLR 41 (Mason J, Gibbs CJ).
[163] Langford, (n 161) 314 [10.13].
[164] Ibid 313 [10.12].
[165] Millhouse, (n 6) chs 3 (empirical analysis), 5 (international comparative law), 6 (conclusions).
[166] Millhouse, (n 125) [5.16].

Should Haynes' systemic recommendations find favour, then fiduciary qualities will regain their primacy at law and set Australia on the harmonisation path with international fiduciary standards. It would reinforce the power of fiduciary law to the benefit of investors and beneficiaries so manifestly poorly served by existing statutes. Fiduciary law should not be 'mere polyfilla' to support inconsistent and incomplete statutes: 'clear recognition of the fiduciary nature [of the best interest] and more expansive operation of the duty'[167] is essential. As she opines, the best interest duty is 'the central fiduciary duty of directors, which operates as a catch-all duty …' The present proscriptive-prescriptive typology is not useful to that community. Neither is it consistent with international trends, with comparative jurisdictions, or the Global Fiduciary Standard.

When considering the re-establishment of trust, other jurisdictions follow one of two paths: (a) accretive statutory reform, or (b) the application of behavioural economics theory to regulation, leading to ex ante industry-based regulation underpinned by universal fiduciary obligations. Presently, Australia, the UK, and the US pursue accretive statutory reform, whilst Canada, Germany (with EU overlay), apply different legal mechanisms reflecting their different legal traditions. These are not without criticism.[168] Singapore pursues a culturally nuanced approach drawing upon legal tradition but implements German standards of personal responsibility supported by *culpa in contrahendo* and *untreue* principles.

The deterrent effect of fiduciary law requires two components: these are (a) prohibition not prioritisation by informed consent; and (b) prescriptive and positive duties to include financial best interest, improved disclosure and education of the client. Informed consent should not be 'a merely formal process'.[169] In Canada, the implementation of the Client Relationship Model (CRM) model requires financial advisers to tutor their clients as they advise them. It has a scholarly basis in behavioural economics research, increases the financial literacy of the community, and provides the human resources ex ante at the interface when and where they are needed.

As Heydon[170] also noted, cultural change to ensure 'reasonable expectations'[171] of fiduciary obligations and principles is a generational task. That loyalty to others, enshrined in the general law but subsumed by statute and contract, should require reinforcement is a sad reflection on the efficacy of Parliament. It is a public policy issue to enforce effective disclosure, require effective conflicts avoidance and balance information and vulnerability asymmetries between provider and client.[172]

[167] Langford, (n 161) 242.
[168] Lisa Zhou, 'Fiduciary Law, Non-Economic Interests and Amici Curiae' (2008) 32(3) *Melbourne University Law Review* 1158.
[169] J Getzler**,** '"As If" — Accountability and Counterfactual Trust' (2011) 91 *Boston University Law Review* 973, 989.
[170] Heydon (n 2).
[171] Tuch, (n 155) 483.
[172] Ibid 505.

How statutes reduce regulatory efficacy: subsuming of fiduciary principles by statutory accretion

Law reform requires: (a) simplification and harmonisation of the various statutes; and, (b) renewed focus on fiduciary principles of propriety, honesty, and uncompromised loyalty. 'The fiduciary obligation is a demanding standard of propriety in conduct that is unequalled elsewhere in the law',[173] requiring 'complete loyalty to the service of another's interests'.[174] Any discussion of law reform needs to comprehend these two themes.

The first imperative is better understood by reflecting on analysis of international practice in comparable jurisdictions and significant and recurring judicial frustration in Australia.[175]

The second imperative will require a national sustained education campaign over a sustained period to inculcate industry participants in director, trustee, and officer roles with these fiduciary concepts. Perhaps a role for a reformed FASEA. Misuse of 'fiduciary' the adjective by politicians and lobby groups has resulted in a mismatch of community expectations based on common usage and the legal reality of fiduciary law in Australia.[176]

Presently, comprehension and application of fiduciary principles is not widespread, given lip-service, often ignored, eliminated in contract, and subservient to adherence to specific statutory provisions. Compliance with the letter of the law but not adherence to its spirit or community expectation. There is a public policy question as to whether Australian statutes 'adequately protects those to whom the general law would grant protection, if enforced, afforded by the fiduciary relationship'.[177]

In many cases, 'contracts mean that fiduciary expectations are not legitimate…'.[178] Judicial reticence to interfere in arms-length contracting parties[179] where best interest of clients are contractually overridden does not assist the vulnerable to mount equitable challenges to malfeasance.

---

[173] Ibid 479 citing *Bristol & West Building Society v Mothew* [1998] Ch 1 [16] (Millett LJ).
[174] Ibid 481 citing P D Finn, 'The Fiduciary Principle' in T G Youdan (ed), *Equity, Fiduciaries and Trusts* (Carswell, 1989) 1, 27.
[175] See, eg, *ASIC v Vine*s [2006] NSWSC [14] (Austin J): 'The application of the statutory language is difficult, because of the very wide range of activities conducted in corporate form'. Rares J succinctly expressed his frustrations with statutory accretion in *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in Liq*) [2012] FCA 1028 (Rares J) noting the *Corporations Act* and *ASIC Act* have lengthy and different definitions of financial services and financial products: he questions the costs of statutory complexity to the community: see Millhouse (n 125) [4.17]–[4.19] . S 62 of the *SIS Act* is 'complex, clumsy and lacks clarity … it takes over 900 words to say that a superannuation fund must be set up to provide benefits …' quoted in Anthony Asher, *Superannuation 'objective' likely to be captured by industry* (The Conversation, April 2016), <https://the conversation.com>.
[176] M Scott Donald, 'Regulating for fiduciary qualities of conduct' (2013) 7(2) *Journal of Equity* 142 [1].
[177] Tuch, (n 155) 514.
[178] Fiduciary Duties of investment Intermediaries, Law Commission UK (Paper No 350, 30 June 2014) [8.48] ('Intermediaries UK 2014')
[179] *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64 [100]–[102] 71 (Gibbs CJ, Mason, Wilson, Deane and Dawson JJ) citing *Paul Dainty Pty Ltd v National Tennis Centre Trust* (1990) 22 FCR 495, 515–516.

> Even where the relationship is contractual (as it normally will be), the matter is too important to be left entirely to the agreement of the parties and the interpretation of that agreement … A too casual failure to recognise the requirements of a fiduciary position, and sometimes a short sighted assumption that all relevant duties are prescribed in contract, can be and has been responsible for serious misbehaviour in the financial markets and elsewhere, as shown by many litigated cases in the last quarter-century.[180]

Empirical analysis demonstrates that the 'Age of Statutes'[181] has not prevented, in any meaningful sense, an elimination of systemic problems — they may have added to the problem.[182] Statutory evolution has been and remains politically contested, its effectiveness reduced as lobby groups pursue their particular interests.

Accretive statutory change is not enough. Whilst 'we now live in an age of statutes and not of the common law,'[183] it is not statute that has eliminated systemic failures and their cyclical manifestations. '[C]omplying merely with the regulatory requirements may well leave the investment bank in breach of the fiduciary obligation'.[184] Cyclical corruption rooted in cultural mores[185] requires excision, not management. This requires a rethink of assumptions of robustness in statutory construction,[186] and of the embracing of 'principles drawn from the law of trusts and from fiduciary law...'[187] In economics terminology, there is market failure: 'These problems are at the core of the structure of the financial markets'.[188]

8. Architecture for implementation at the financial consumer level — financial planning and wealth management as a profession

Ripoll[189] recommended the *Corporations Act* be amended to explicitly include a statutory fiduciary duty for licenced financial advisers. This generated debate as to why a financial adviser should have a statutory fiduciary duty at all. ASIC's submission to Ripoll proposed that 'legislation should expressly impose an explicit 'fiduciary-like' duty on financial advisers requiring them to give priority to their clients' interests

[180] Fiduciary Duties UK 2013 (n 106) 171 citing Peter Watt (ed), *Bowstead & Reynolds on Agency* (Sweet & Maxwell, 19th ed, 2010) [6–043].
[181] Leeming, (n 41) 108.
[182] Millhouse, (n 1).
[183] Paul Finn, 'Public Trusts, Public Fiduciaries', (2010) 38 *FLR* 342, 350 citing G Thomas, 'The duty of Trustees to Act in the "Best Interest' of their beneficiaries' (2008) 2 *Journal of Equity* 177.
[184] Tuch, (n 155) 516.
[185] Heydon (n 2).
[186] Finn, (n 183).
[187] Finn, (n 183) 335.
[188] Tuch, (n 155) 516.
[189] Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Inquiry into Financial Services and Products in Australia*, 2009 ('*Ripoll*').

ahead of their own'.[190] The Commonwealth responded with the FoFA[191]reforms which did not include a statutory fiduciary duty, only a statutory best interest duty.[192]

Clients are in a lesser legal position than before those reforms. *FoFA* subsumes general law fiduciary duty behind compliance with statutory process, safe harbour defence for compliance with that process,[193] has differing liability for employees of financial planning firms and their authorised representatives and does not extend procedural protections to non-retail investors (who may only have retail level skills). Political influence is the cause: it is a sop, without remedy, removing general law protection of undivided loyalty of financial and corporate advisers to their retail clients. It further entrenches the doctrine of prioritisation over prohibition, continued by FASEA. It ignores the essential contribution of financial products and services provision to daily life. It is industry centric, not consumer centric,

Applying the Canadian SRO/CRM Model in Australia

If the objective of further Australian reform is to transform its financial planning and wealth management sectors into a respected profession, this will require reform of how regulation is implemented and reform of Australia's restrictive fiduciary tradition. The distinctive Canadian regulatory system based on fiduciary duty and responsive regulation has much to offer Australia in this quest for reform of its financial advisory sector. It evolves the regulation of financial services advice into an ex ante posture delivered and policed by the financial planning industry organisations themselves. They would have regulatory responsibility supervised, audited and enforced by ASIC.

They will also have financial literacy objectives. They will replace government agencies including ASIC in financial literacy education. These are mostly tactical and antiseptic, ignore behavioural economics research which requires active interventions in 'teachable moments'[194] alongside the provision of proper, useful and comprehensible disclosure during active investing. One objective is to generate deeper client relationships disciplined by fiduciary responsibility and improved client financial literacy. Proximity to the client engenders knowledge transfer and the re-establishment of trust. The fiduciary obligation is

[190] Australian Securities and Investments Commission, Submission to the Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Inquiry into Financial Services and Products in Australia* (August 2009) tab 2, 12.
[191] *Corporations Amendment (Future of Financial Advice) Act 2012* (Cth); *Corporations Amendment (Further Future of Financial Advice Measures) Act* 2012 (Cth).
[192] Hanrahan notes that the [Ripoll] recommendations were 'initially adopted in April 2010, but in November 2011, the then responsible Minister moved away from categorising the duty as fiduciary, describing it as a "statutory best interest duty"': Pamela F Hanrahan, 'The relationship between equitable and statutory 'best interest' obligations in financial services law' 7(1) *Journal of Equity* (2013) V. The FSC argued for this outcome. The FPA supported further amendment of *Corporations Act* s 961B(2)(g) to the best interest duty in December 2013 which allowed for 'scaled advice'. See also Cooper, above n 40, Pt One App K 157. Political influence was raised in respect of FoFA and APRA in the qualitative research. See also Ben Butler, 'Can a change of guard fix ASIC's image?', *The Weekend Australian Business* (Sydney), 22–23 March 2018, 29.
[193] *Corporations Act 2001* (Cth) s 961B(2).
[194] S Schwartz, 'The Canadian Task Force on Financial Literacy: Consulting without listening' (2011) 51 *Canadian Business Law Journal* 338, 352. See also Millhouse (n 205) [6.208].

underpinned by personal liability of directors and senior management extending to the approval of financial products provision to clients. Proximity renders the need for safe harbour defence obsolete.

The Australian equivalent of the CRM will need to account for the rapid march of technology. ASIC asserts a technology neutral regulatory environment.[195] Some scholars assert that 'financial consumers are *more* willing to trust the digital platform than a face-to-face adviser,[196] noting that 'willingness … to trust the robo-adviser comes close to Finns' '"fiduciary expectations" thesis'.[197]

The meaning of 'best interest' can be informed by adopting The Global Uniform Fiduciary Standard. Some jurisdictional codes provide guidance. In Canada, best interest standards automatically include fiduciary and non-fiduciary duties from all sources of law in its CRM enforced through SROs. This eliminates present ambiguity in Australian best interest interpretations. Duties would extend to the SRO, its directors, officers, professional advisers, and their financial planners.[198] As in Canada, Australia would have a principles-based interpretation of the nature and scope of fiduciary obligations in financial advice which meet implicit community assumptions. It results in a uniform fiduciary standard previously proposed in the US.[199] SRO models require implementation support of fiduciary law and effective enforcement by the regulator.

The necessary national infrastructure presently exists in Australia. The Australian SRO model would apply inter alia to the Financial Services Council (FSC), Association of Independently Owned Financial Planners (AIOFP), Financial Planning Association (FPA), Association of Financial Advisers (AFA), and the Independent Financial Advisers Association of Australia (IFAA). These organisations will require reform of their objectives, governance, culture, and operations to implement the model. They would become regulators generating 'significant compliance and cooperation',[200] not industry lobbyists, themselves attempting to apply the FASEA Code of Ethics.

Two strategic benefits arise: these are the removal from ASIC of the impossible burden of policing ex post, every financial advice transaction, and transitioning the financial planning sector into a self-regulated ex ante supervised profession with fiduciary status. Enforcement of Australian SROs would be ASIC's role, similar to Canadian Securities Administrators.

---

[195] *Providing digital financial advice to retail clients* (ASIC Regulatory Guide 255, August 2016) [RG255.6].
[196] Simone Degeling and Jessica Hudson, 'Financial Robots as Instruments of Fiduciary Loyalty' (2018) 40 *Sydney Law Review* 63, 78.
[197] Ibid citing Paul Finn, 'Fiduciary Reflections' (2014) 88(2) *Australian Law Journal* 127, 139.
[198] Directly employed and Authorised Representatives
[199] P Demina, 'Broker-Dealers and Investment Advisers: A Behavioural Economics Analysis of Competing Suggestions for Reform' (2014) 113 *Michigan Law Review* 429, 439 citing M S Barr et al, 'The Case for Behaviourally Informed Regulation' (2009) *New Perspectives on Regulation* 25.
[200] Laura Paglia, *Standard of Conduct for Advisors and Dealers: Exploring the Appropriateness of Introducing Statutory Best Interest Duty when Advice is provided to Retail Clients*, (Canadian Securities Administrators Consultation Paper 33-403, 2013) 27.

These reforms would solve the systemic problems in the financial advice sector in Australia which incremental Australian statutory reforms to date, including FoFA[201] do not. Implementation must be statutorily supported: eliminate non-reliance clauses in advisory contracts which remove fiduciary liability; extend client fiduciary obligations to the directors and senior management (which cannot be delegated) of financial advisory and wealth management firms; and apply retail consumer protection law to the sale of all financial products and services. As in Canada, remove statutory safe harbour defence in retail financial advice.

Elevation of financial planning to professional status will require the licencing of financial planners personally based on personal educational and performance competencies, consistent with a revised FASEA 'Relevant Providers' examination. Personal licensing facilitates transferability of skills sets and places responsibility directly with the individual fiduciary.

9. Market conduct regulation for the 21st century

Regulatory and supervisory agencies are an essential component of the national architecture. They too, must share the reform objective. Indeed, it is in their interest to do so: reform is the only means by which they can ameliorate and eliminate the excoriating criticisms they have faced.

ASIC is mandated as an ex-post market conduct regulator with broadening responsibilities.

> [E]x post strategies are often dysfunctional in the light of behavioural economics … [which] reveal that the traditionally highly legislated monitoring and control strategies need to be evaluated in a different light … to avoid mindless decision making…[202]

ASIC is a prisoner of its *ASIC Act* and the *Corporations Act*. It has not met its stakeholder expectations.[203] It should lead, not follow, by setting out a proposed reform agenda having considered the research available to it. A redefined charter requires amendment of the *ASIC Act*.[204] A redefined mandate leads directly to analysis of ASIC's human and financial resources required for implementation. As with the BaFin, a culture of natural politeness (in administrative compliance), powers being exercised in commercially relevant timescales, and stakeholder respect (including in enforcement) is a component of the spirit of the law. As in the German governance system,[205] stakeholder representation should be balanced with management competencies. Its mandate and its reactive, issue-based posture is 'not fully replicated by any other conduct regulator globally'.[206]

---

[201] *Corporations Amendment (Future of Financial Advice) Act 2012* (Cth); *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth).
[202] Hoeppner and Kirchner, (n 39) 251.
[203] K Chester, M Gray and D Galbally, *Fit for the future: A capability review of the Australian Securities and Investments Commission —A Report to the Government*, Report, December 2015 cited in David Millhouse, *Corporate Governance in Non-Bank Financial Entities* (LexisNexisButterworths, 2019) [2.219]–[2.222].
[204] *Australian Securities and Investments Commission Act 2001* (Cth) s 1(2).
[205] Millhouse (n 125) [7.76]–[7.82].
[206] Chester, Gray and Galbally, (n 203) 34.

Insights from comparative jurisdictions

Balancing industry development with compliance cultures requires pragmatism. This pragmatism should extend to clarity, certainty, and consistency in public policy, law, and regulation both prescriptive and principles based. Singapore's objective is to reduce 'productivity sapping ambiguities'.[207] Pragmatism, within a unified system of law, is an objective of German financial regulation. A combination of principles-based regulation observing the spirit as well as the letter of the law founded on natural politeness, consultation, civil law duty of care and fiduciary doctrines, and proximity to supervised entities gives predictability to stakeholders. Canada, similarly, has embarked on a regulatory journey cognisant of behavioural economics research and given legislative form as Responsive Regulation with implementation through its SROs. Australia's box-ticking compliance culture could be made obsolete by emulation of these insights.

Conversely, the UK as in Australia, community anger at misplaced expectations generates public demand for revenge for subversion of economic interests behind statutory compliance. Public demand results in political pressure for prescriptive supervision by the same regulators that have been part of the problem. There is some recognition in the UK that regulators cannot police every commercial transaction or police corporate culture. That is not recognised in Australia where ASIC is expected to do both at ever increasing cost, an impossible burden. That compliance with process has not led to expected investor outcomes will be a cultural challenge for it and proponents of statutory accretion.

Ex Ante or Ex Post Regulation?

The objective is to eliminate inexhaustible demands for market conduct services from the central regulator.[208] Ipso facto, ASIC regulation becomes ex ante and supervisory rather than ex post and reactive. Behavioural economics scholarly research supports this change in posture, regarding ex post strategies as 'behaviourally dysfunctional … [requiring a] counterintuitive shift of rule-making competencies: from public to private ordering.'[209] In effect, Responsive Regulation. Discipline in implementation will be strict: underpinned by fiduciary obligation in the investment chain enforced by an effective properly mandated ASIC.

This should reduce the ex post unintended consequences of regulatory action which can easily result in significant and detrimental impacts, loss of investor confidence (present and prospective), and compromise of underlying assets values.[210]

[207] Andrew Campbell, 'Insolvent Banks and the Financial Sector Safety net – Lessons from the Northern Rock Crisis' (2008) 20 *Singapore Academy of Law Journal* 316, 337.
[208] D Kingsford Smith, (n 101) 702.
[209] Hoeppner and Kirchner, (n 39).
[210] Australian Government The Treasury, *Review of the Trio Capital Fraud and Assessment of the Regulatory Framework* (Report, 2013) 14.

Educational Standards, Competencies, and Culture in Regulatory Agencies

> Whilst 'the role of a publicly funded regulator is to deter unlawful behaviour … it [ASIC] is tasked to regulate for the benefit of society as a whole'.[211] This necessarily means lifting standards of behaviour and competence of market participants.[212] Empirical analysis suggests this objective has not been reached. Effective regulators must have a stakeholder and societal teaching role including in the training of directors and trustees — it is a component of supervision, lifts standards and competencies of lay people appointed to boards. ASIC staff need skills sets to take personal responsibility for timely and useful relationships with client stakeholders who now provide ASIC's funding. ASIC needs to build its own CRM.

Surveillance, compliance and enforcement are important but not the only tools in market integrity. Haynes' 'Why not litigate?' hypothesis may have unforeseen consequences — these presently include increases in D&O insurance costs and director flight. A culture of retribution is now embedded relating to director and trustee disqualifications and enforcement actions. It is punitive and serves to diminish entrepreneurial endeavour. The author's qualitative research[213] reports board paralysis. Cases of corporate failure often result in public examinations of the directors who can be held up to ridicule, contempt, even when there is no breach of duty.[214] A doctrinal approach should be rehabilitative.

10. Corporate governance reform — related party transactions and conflicts of interest

Corporate Governance is the implementive cousin of the law — including its spirit and its intent. Australian governance law is extremely complex.[215] Empirical analysis identifies systemic deficiencies in the regulation of related party transactions and conflicts of interest.[216] International regulatory principles designed to improve corporate regulation and behaviour,[217]

---

[211] Michelle Welsh and Vince Morabito, 'Public v Private Enforcement of securities laws: An Australian empirical study' (2014) 14(1) *Journal of Corporate Law Studies* 39, 46, 78.

[212] *Australian Securities and Investments Commission Act 2001* (Cth) s 1(2).

[213] Millhouse, (n 6) app 1.

[214] See, eg, *Kelaher* (n 74).

[215] See, eg, Drummond AJA in *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No3)* [2012] WASCA 157 [2051]: 'The impacts of corporate decision-making on a wider range of interests than shareholders are now being given more recognition. The need to ensure protection of those interests also I think serves to explain why modern company courts have become more interventionist, in reviewing the activities of directors than was traditionally the case'; See also, Commonwealth, HIH Royal Commission, *The Failure of HIH Insurance Final Report* (April 2003) (Commissioner Owen) quoted in R A St John, CAMAC, *Corporate Duties below board level* (Report, April 2006) 47: '[t]he uncertain state of the law in this area has been a source of difficulty in my assessment of those cases where there might have been a breach of the law ... '. As Kirby J acknowledged in *Rich v Australian Securities and Investments Commission* [2004] HCA 42 [116]-[117], 'Such were the demonstrated abuses and errors in the management of Australian corporations in the 1980's that widespread demands were made for an end to complacency and for an attack on "bad corporate governance" being systemic "serious danger to the economy of the nation inherent in the multiple corporate collapses of the 1980's, repeated in equally spectacular form in more recent years"'. See also, Justice Michael Kirby, 'The company director: past, present, and future' (Speech delivered at the Australian Institute of Company Directors, Tasmanian Division, Hobart, 1998). See generally Du Plessis, 'Reverberations after the HIH and other recent corporate collapses: the role of ASIC', (2003) 15 *Australian Journal of Corporate Law* 225.

[216] Millhouse, (n 1).

[217] Organisation for Economic Cooperation and Development, *Principles of Corporate Governance* (1999); See also Jillian Segal, 'Corporate Governance: substance over form' (2002) 25 *University of New South Wales Law Journal* 320.

> emphasise managerial and directorial responsibilities and community expectations of a more proactive regulation of corporations, aimed at the steady maintenance of standards and integrity and competence in corporate governance. They reflect the view that participation in corporate governance is a privilege enjoyed by individuals subject to compliance with conditions. It is not a private right to be defended …[218]

It is not only directors and trustees who are frustrated by complexities in the law.[219]

> Especially in an Act as large and cumbersome as that under consideration (with its history of patchwork accretions), it is impossible to be confident. …[220] The construction of the Act now adopted needlessly restricts the Commission [ASIC] and the court in trying the claim. …[221] Doing so seriously impedes the Act's important purposes for corporate governance in this country.[222]

There is considerable disharmony in Australia surrounding governance,

> free of the type of conflicts that may cause them (either intentionally or unintentionally) [to] serve the interests of the [employer and employee] sponsors, a related party or a subset of members, rather than the fund's entire membership.[223]

This conflict is politicised, legislative intervention highly contested, preventing rational reform. Vested interest, resistance to change, based on spurious argument or misunderstanding clouds serious reform within the swirling mists of Lilliputian conflicts. This arises from the different roles of representative stakeholders and board level competencies required to properly supervise management in meeting statutory and beneficiary objectives, 'It is more important for directors to be independent, skilled, and accountable than representative'.[224] Empirical research supports this view: '[t]rustees lack experience, training or suitable knowledge, creating the potential for not fully understanding advice that they receive from outside experts.'[225]

Other jurisdictions have governance models which do give effect to the interests of all stakeholders. These have long been a feature of the German corporate governance environment[226] which allocates authority to 'alleviate conflicts of interest'.[227] Adopting this model in the context of Australian superannuation entities, and others

---

[218] *Rich v Australian Securities and Investments Commission* [2004] HCA 42 [119] (Kirby J) ('*Rich*').
[219] Allens Linklaters, Mergers and Acquisitions Focus: Corporate Governance (March 2003).
[220] Rich (n 218) [122].
[221] Ibid [132].
[222] Ibid.
[223] Senate, Economics Legislation Committee, Parliament of Australia, Superannuation Legislation Amendment (Trustee Governance) Bill 2015 2.5.
[224] Murray, (n 61) 135.
[225] Thi Thuy Chi Nguyen, Monica Tan and Marie-Anne Cam, 'Fund governance, fees and performance in Australian corporate superannuation funds a non-parametric analysis' (2012) 11(2) *The Journal of Law and Financial Management* 2, 7.
[226] Klaus J Hopt and Patrick C Leyens, 'Board models in Europe – Recent Developments of Internal Governance Structures in Germany, the UK, France, and Italy' (2004) 2 *European Company and Financial Law Review* 135, 162.
[227] Carsten Gerner-Beuerle and Edmund-Philipp Schuster, 'The Evolving Structure of Directors' Duties in Europe' (2014) 15 *European Business Organisation Law Review* 191, 207.

controlled by representatives of registered organisations may provide a better model of governance of those entities and a solution to present policy conflicts. The 'advantage of the German system is the clear division of function'.[228] This separation of form and function echoes US governance reform promoted by the American Law Institute (ALI).[229] The supervisory board is the German equivalent of ALI preference for 'a majority of independent directors … free from any significant relationship with the corporation's senior executives'.[230]

Applying the German Corporate Governance Model to Australia

How is reform to be implemented in Australia? What is the best mechanism to unlock economic benefits from governance reform in a contested political environment?

The two-tier board system achieves by governance design what Australia seeks to achieve by statute. It is consistent with contested governance reform of Australian superannuation entities.[231] The importance of form matching function increases as Australian entities invest internationally and for those which seek international investment. German style corporate governance is designed not only for 'the maximisation of shareholder value, but ensuring stability and growth'.[232]

Emulation of a two-tiered corporate governance structure (Supervisory Board and Management Board) would reform Australian NBFE corporate governance in superannuation and MIS environments. Stakeholders would appoint the supervisory board which then appoints and terminates a non-conflicted professionally competent management board. The voluntary Code of Trustee Governance for superannuation entities should be reviewed, become binding, and applied widely, following the EU comply-or-explain paradigm and benchmarked inter alia against the GCGC.

German statutory provisions are extensively supported by soft law designed to promote 'a culture of open discussion in managerial and supervisory bodies'.[233] This includes the extra-judicial GCGC,[234] the OECD Ad-Hoc Task Force on Corporate Governance, and institutional activism.[235] The corporate governance code

[228] Grit Tüngler, 'The Anglo-American Board of Directors and the German Supervisory Board – Marionettes in a Puppet Theatre of Corporate Governance or Efficient Controlling Devices' (2000) 12(2) *Bond Law Review* 230, 269.
[229] Ibid 250.
[230] Ibid 250.
[231] Superannuation Legislation Amendment (Trustee Governance) Bill 2015 (Cth).
[232] Andreas Hackethal, Reinhard H Schmidt and Marcel Tyrell, 'Banks and German Corporate Governance: on the way to a capital market-based system?' (2005) 13(3) *Corporate Governance: The international journal of business in society* 397, 398.
[233] Tüngler, (n 228) 230, 245.
[234] German Corporate Governance Code.
[235] Tüngler, (n 228) 230, 268.

'strengthened the strategic role of the supervisory board',[236] now given statutory force,[237] and updated annually. Since 2012, companies have to explain their reasons for noncompliance.[238]

'Since 2002, [German] company law requires both boards of listed German corporations to declare their conformity to the German Corporate Governance Code'.[239] Directors of listed and unlisted companies may be liable for not meeting comply-or-explain provisions of the GCGC or merely for not acting in accordance with a specific governance rule.[240] Modern German legal practice places responsibility for management supervision with the individual directors of the supervisory board and provides them with 'sufficient power to focus the managers' minds in the right direction'.[241] 'Promoting entrepreneurship is high on the agenda … and reflected in a number of company law [reform] initiatives'.[242] Whilst partly a response to corporate mobility, treaty shopping or 'regulatory arbitrage' around the EU, it is also a recognition that 'regulatory burdens generally have a negative effect on entrepreneurship.'[243]

Empirical Outcomes

Performance disclosure is publicly contested in Australia. Ultimately, the efficacy of governance in the Australian context will be a test of long-term empirical performance. Empirical research on the German two-tier board system dates from 1998.[244] Empirical analysis demonstrates that:

> The degree of compliance with the Code is consistently value-relevant information for the capital market … Firms with a higher compliance are priced at an average premium … consistent with the hypothesis that there are capital market pressures (or at least incentives), suggesting a broad adoption of the Code...[245]

[236] K J Hopt and P C Leyens, 'Board models in Europe — Recent development of Internal Governance Structures in Germany, the UK, France, and Italy' (2004) 2 *European Company and Financial Law Journal* 135.
[237] *Stock Corporation Act* (Germany) 1965 ('AktG') § 161.
[238] Thomas Kaspereit, Kerstin Lopatta, and Dennis Onnen, 'Shareholder Value Implications of Compliance with the German Corporate Governance Code' (2015) in *Managerial and Decision Economics,* wileyonlinelibrary.com DOI:10.1002/mde.2750.
[239] Igor Goncharov, Joerg Richard Werner and Jochen Zimmerman, 'Does Compliance with the German Corporate Governance Code have an Impact on Stock Valuation? An empirical analysis' (2006) 14(5) *Corporate Governance: The international journal of business in society* 432.
[240] M Kort, 'Standardisation of Company Law in Germany, other EU Member States and Turkey by Corporate Governance Rules' (2008) 5 *European Company and Financial Law Review* 379, 417–418.
[241] Andrew Ross and Kenny Crossan, 'A review of the influence of corporate governance on the banking crises in the UK and Germany' (2012) 12(2) *Corporate Governance: The international journal of business in society* 215, 223.
[242] Mette Neville and Karsten Engsig Sorensen, 'Promoting Entrepreneurship — The New Company Law Agenda' (2014) 15 *European Business Organisation Law Review* 545.
[243] Ibid 554.
[244] John H Farrar, 'In pursuit of an appropriate theoretical perspective and methodology for comparative corporate governance' (2001) 13 *Australian Journal of Corporate Law* 1.
[245] Goncharov, Werner and Zimmerman, (n 239) 442.

The average share price premium of €3.23 on a median of €29.17 and mean of €35.05 is significant. This analysis of 2 379 German companies GCGC compliance associated with their higher market valuation.[246] Unitary board models have not shown similar results.[247]

Later research (sample size 292 UK and German insurers and reinsurers) confirms these findings:[248]

> a higher level of compliance significantly increases shareholder value ... [we] conclude that the GCGC rules are meaningful to the market and that executives ought to pursue full compliance with the recommendations of the Code.[249]

These studies imply foregone value to Australian securities holders and beneficiaries as a result of less optimal corporate governance practices.

11. Conclusions

The four reform themes must be sequenced, taking 'significant time for construction, debate, refinement and implementation'.[250] Strategic reform requires acceptance and implementation by the various stakeholder groups. The effectiveness and stability generated by prudential supervision needs to be embedded as a governance value system — a culture — within the non-prudentially regulated sector. Successful implementation aligns interest of provider and consumer: it also changes the role of the regulators — they become educators, supervisors. A healthy culture results in enforcement becoming a last resort.

Reform should be financial consumer centric, not supplier or regulator centric. Financially independent retirement for Australians is a pipe-dream if that focus is compromised. Consumer empowerment through improved financial literacy and destruction of power imbalances in the investment chain requires oversight outside of existing supervisory structures. 'An informed, expertly staffed and independent institution evaluating financial regulations and regulatory actions from the public's point of view'.[251] This will allow different views to be heard, not subsumed by existing vested and politicised interests who will regroup and dilute proposed reforms that affect those interests.[252]

Resolution also includes emulation of models and standards from other jurisdictions which themselves have dealt with similar systemic failures. There are examples where professional and industry associations are quasi-regulators working from the bottom up, educative and consultative, thereby reducing inexhaustible demands for

[246] Kaspereit, Lopatta and Onnen, (n 238).
[247] Ibid citing D Laing and C M Weir, 'Governance structures, size and corporate performance in UK firms' (1999) 37 *Management Decision* 446, 457.
[248] Martin Eling and Sebastian D Merek, 'Corporate Governance and Risk Taking: Evidence from the U.K. and German Insurance Markets' (2013) 81(3) *The Journal of Risk and Insurance* 653, 670.
[249] Kaspereit, Lopatta and Onnen,(n 238).
[250] M Scott Donald, 'Super needs a better regulator, not more rules' 6 November 2014 *Australian Financial Review* (Sydney) Editorial & Opinion, 55.
[251] Stijn Claessens and Laura Kodres, 'The Regulatory Responses to the Global Financial Crisis: Some uncomfortable questions' (Working Paper No 14/46, International Monetary Fund, March 2014) 26 citing James Barth, Gerard Caprio and Ross Levine, *Guardians of Finance* (MIT Press, 2012).
[252] See, eg, Donald, (n 250).

market conduct services from the central regulator, making for more effective 'Responsive Regulation',[253] presently given lip-service rather than practical implementation. The basis of necessary infrastructure exists in Australia today.

Scholarly research has demonstrated the difference between compliance based cultures and values based cultures and how 'assumptions of rationality in economic theory are contradicted by experimental evidence'.[254] This important behavioural economics research has global multi-jurisdictional implications[255] but receives only limited scholarly attention in Australia. It supports change in posture, regarding ex post regulatory strategies as 'behaviourally dysfunctional' requiring a 'counterintuitive shift of rule-making competencies: from public to private ordering.'[256] '[I]t is doubtful whether [ex post] monitoring can be done cost effectively'.[257] Consequential superior stakeholder outcomes are also supported by empirical analysis.[258]

Evolution to an ex ante Responsive Regulation model requires discipline in those that implement it. There is a tendency to confuse principles based regulation, including reliance on fiduciary obligations, with light touch regulation, a misnomer — 'a principles-based approach does not work with individuals who have no principles',[259] — nor indeed does statute with those inclined to creative compliance. The extension of fiduciary responsibility to prospective malfeasors, properly enforced is certainly not light touch.

The Damoclean Sword over improper conduct is to be provided by fiduciary obligation in the investment chain enforced by effective regulators seeking judicial support:

> [F]iduciary duties are difficult to define and inherently flexible. We think that is one of their essential characteristics: they form the background to other more definite rules, allowing the courts to intervene where the interests of justice require it[260]

'[T]he term "fiduciary duty" means different things to lawyers and non-lawyers. Even lawyers use the term in different ways.'[261] Therefore, [t]here needs to be clarity about fiduciary responsibility, backed by a tough regulatory regime that says: if you misbehave, you are out — and for good.[262]

Why is Australia reluctant to embrace statutory fiduciary obligation in the investment chain? Why, in Australia, are the economic interests of investors and beneficiaries subsumed by processes of statutory compliance? Why

---

[253] D Kingsford Smith, (n101) 702.
[254] Don Mayer, Anita Cava and Catharyn Baird, 'Crime and Punishment (or the Lack Thereof) for Financial Fraud in the Subprime Mortgage Meltdown: Reasons and Remedies for Legal and Ethical Lapses' (2014) 51(3) *American Business Law Journal* 515, 534 citing Dan Ariely, *Predictably Irrational: The Hidden Forces That Shape Our Decisions* (Harper Perennial, 2010).
[255] Ibid 541.
[256] Sven Hoeppner and Christian Kirchner, (n 39) 227.
[257] Ibid 231.
[258] Neville and Sorensen, (n 242); Goncharov, Werner and Zimmerman (n 245); Kaspereit, Lopatta and Onnen, (n 246); Eling and Merek, (n 248).
[259] Iain MacNeil, 'The Trajectory of Regulatory Reform in the UK in the Wake of the Financial Crisis' (2010) 11 *European Business Organisation Review* 483, 499.
[260] Fiduciary Duties UK 2013 (n 104) 171.
[261] Intermediaries UK 2014 (n 178) [3.11].
[262] Lord Myners, (Third Report of the Select Committee on Business, Innovation and Skills UK, 2013–14) House of Commons 603 Evidence 19.

do Hayne's systemic recommendations, central to such reforms, remain in limbo, except by an unfunded ALRC? From a community expectations perspective, '[f]eelings of exploitation feed naturally into fiduciary law's rhetoric of betrayal.'[263]

Community expectations of fiduciary obligation are based on 'the reasonable expectations of one person that another would act in his [practical] interests … The Canadian model is 'admirably capacious'.[264] A beneficiary may establish a fiduciary relationship unilaterally', provided there is a reasonable basis,[265] surely a Damoclean Sword.

In Germany, pure liability fiduciary-like civil law duties of care are now codified in EU statutes. If Australian directors and advisers were subject to German duty of care civil law *untreue* and *culpa in contrahendo* fiduciary-like doctrines (in their proscriptive and prescriptive formulations), supreme rather than subordinate, they would be less likely to hide behind statutory and contractual box-ticking.

This is where Australian law[266] and law of comparable jurisdictions may begin to converge — reflecting community expectations of the law. Creative compliance then becomes risky for its practitioners.

[263] Richard Joyce, 'Fiduciary Law and Non-Economic Interests' (2002) 28 *Monash University Law Review* 237, 240.
[264] Miller, (n 112) [102].
[265] Ibid [70].
[266] See generally, Donald, (n 47).